RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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LETTER 1327

November 21, 2001

Nov. 2, DJIA 9323.61, PTI 5319, A-D Ratio -3.28
Nov. 9, DJIA 9608.20, PTI 5333, A-D Ratio -2.59
Nov. 16, DJIA 9866.99, PTI 5340, A-D Ratio -1.95
Dow yield: 1.83% Dow p/e: 27.2
Gold 50-day MA: 283.80

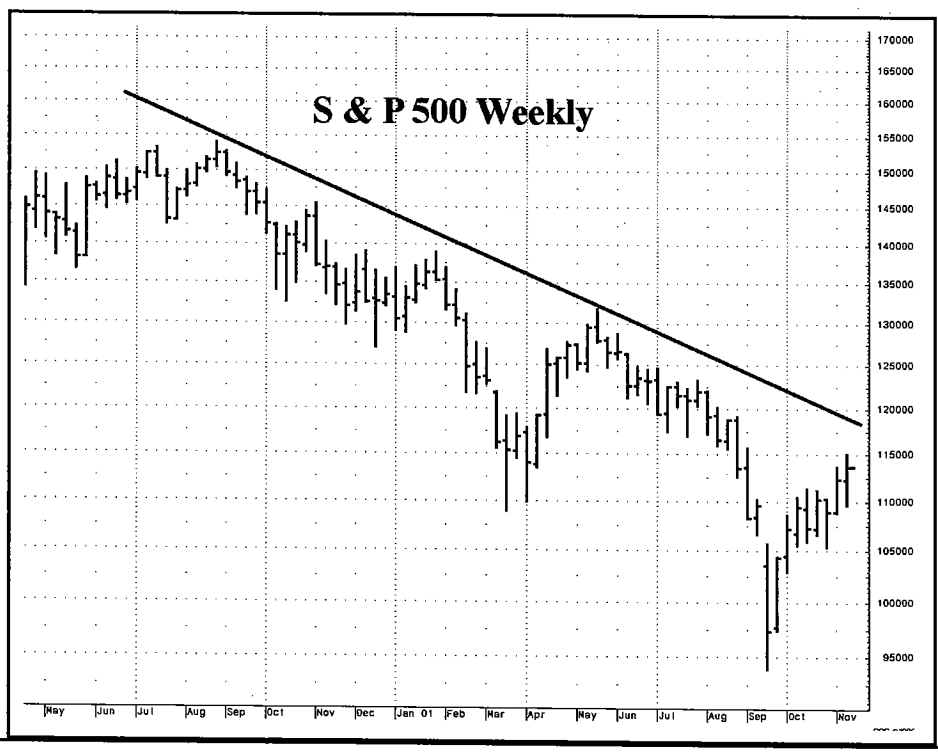
Standard&Poor's 500 – This is the index that most professionals trade and base their actions on. And the S&P futures are followed by investors day and night.

This is a weekly chart of the S&P running from May of 2000 to the present. Note that the rally, so far, has not reversed the declining trendline that has been in force since late August of 2000.

Note also that the current rally is not greater in extent than the previous rally that began in March of 2001. That rally lasted eight weeks and then failed.

What is so interesting is that this latest rally has whipped up such an extraordinary amount of optimism and bullishness, with many analysts announcing that "the bear market is over." In my experience, the first rally off a bear market bottom is greeted with total skepticism, even with anger. That's hardly the case with the latest rally.

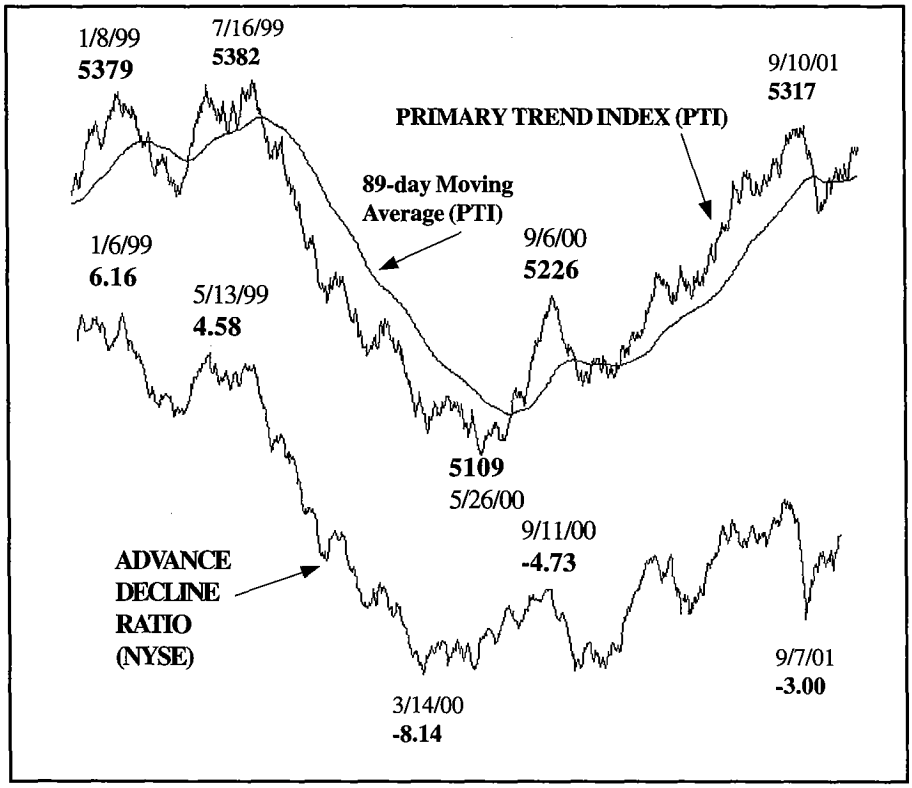
THE PICTURE: One of the disciplines I've had to learn in this business, and believe me it takes a long time to learn it, is to ignore all the advice, predictions, warnings, optimism and pessimism of the so-called "experts." And never in US history have there been so many experts, gurus, soothsayers, professional fund managers, CEOs, talking heads as now. The list is endless.



And the banter is endless. It's on TV around the clock, it's on radio, it's in your morning newspaper and it's in magazines. I read a lot of it because I'm always hopeful of finding something that I think is important. And, of course, I like to see what other people are saying because it gives me a feel for current sentiment.

But in the end this is a lonely business. If you can't stand alone, if you aren't able to read what the reigning guru is saying and then ignore it — then don't go into this business.

I've said this many times, but I'll say it again. There's only one expert in the



investment business and that's the stock market itself. Everything known by anyone anywhere at any time is "built" into the structure of the D-J Averages.

But naturally, over the years a lot of items have been added, items which hopefully will help you and me to analyze the stock market correctly. Today I follow dozens of indices and indicators, but my overall opinion is always based on my interpretation of Dow Theory. The Dow Theory, when correctly interpreted, tells us the direction of the great primary trend of the market.

The direction of the primary trend is the single most important piece of information that an investor can possess. Given a primary bull market, all strategies and tactics have to do with eventual higher prices, and it's critical to understand this.

Given a true primary bear market, everything you know and do should be guided by the knowledge that through time prices of everything from stocks to homes to items in the grocery store will be lower.

These are simple concepts on their face, but exceedingly difficult concepts to operate on. Why are they difficult? Because the market, like an expert Las Vegas card player, loves to hide what's in its hand.

During the 1930s and early 1940s my father would own only two stocks. The two stocks were American Telephone and Woolworth's. Why only those two stocks? Because during the entire Depression these two stocks were never in danger of cutting their dividends. Telephone paid its famous nine-dollar dividend all through the Depression, and many people literally survived on that dividend. And, of course, Woolworth's was the favorite store for many of us during the Depression. Those were the days people called Woolworth's the "five and ten," and it was true, almost everything in Woolworth cost a nickel or a dime.

During the 1930s, the 1940s and much of the 1950s, stocks dividends were respected and greatly desired. In those days people bought stocks as investments, usually as long-term investments. A great many blue-chip stocks sold at around ten times earnings while yielding 6% or more. People bought stocks for income in those days, and if the stocks milled around for months or even a year or so, that was OK, because you had bought the stocks for income, for what it would pay you every quarter.

The criteria for buying stocks in the "old days" was that the stock sold for around ten times earnings, that it paid a "safe, well-covered" dividend of 6% or better, and the whipped cream on the sundae was that the company increased its dividend from time to time.

All that is history. Today, the stock market has been reduced to a "sport." The object of the sport is to buy a stock that "is supposed to double or triple" over the next few years or hopefully even in the next year. Nobody thinks of holding a stock for income. What income? Companies today have gotten out of the habit of paying dividends.

Now all attention is paid to quarterly earnings or quarterly sales. Everything is aimed at moving a stock up. If the stock sinks or wallows around at low levels, it's kicked out of portfolios and its CEO and chief financial officer are given the heave-ho. Since there are no dividends, the only reason to hold a stock is that it might (must) generate capital gains.

So your new "sport" compels you to beat the market on a monthly or weekly or better still – on a daily basis. If not, you've failed. The whole process of "investing" has been reduced to that.

Of course, this goes along with the whole gambling fever that has enveloped the nation.

TIME — Here's something they won't tell you at your local brokerage office or in the "How to Beat the Market" books. All investing and speculation is basically an exercise in attempting to beat time.

"Russell, what are you talking about?"

Just what I said — when you try to pick the winning stock or when you try to sell out near the top of a bull market or when you try in-and-out trading, you may not realize it but what you're doing is trying to beat time.

Time is the single most valuable asset you can ever have in your investment arsenal. The problem is that none of us has enough of it.

But let's indulge in a bit of fantasy. Let's say you have 200 years to live, 200 years in which to invest. Here's what you could do. You could buy $20,000 worth of municipal bonds yielding say 5.5%.

At 5.5% money doubles in 13 years. So here's your plan — each time your money doubles you add another $10,000. So at the end of 13 years you have $40,000 plus the $10,000 you've added, meaning that at the end of 13 years you'd have $50,000.

At the end of the next 13 years you have $100,000, you add $10,000 and then you'd have $110,000. You reinvest it all in 5.5% munis and at the end of the next 13 years you'd have $220,000 and you add $10,000 making it $230,000.

At the end of the next 13 years you'd have $460,000 and you add $10,000 making it $470,000.

In 200 years there are 15.3 doubles. You do the math. By the end of the 200th year you wouldn't know what to do with all your money. It would be coming out of your ears. And all with minimum risk.

So with enough time, you would be rich — guaranteed. You wouldn't have to waste any time picking the right stock or the right group or the right mutual fund. You would just compound your way to riches, using your greatest asset — time.

There's only one problem. In the real world you're not going to live 200 years. But if you start saving young enough or if you start your kids early, you or they might have anywhere from 30 to 60 years of time to build your savings.

Because most people have run out of time, they spend endless hours and nervous energy trying to beat time, which, by the way, is really what investing is all about. Pick a stock that advances from 3 to 100 and if you've put enough money in that stock you'll have beaten time. Or join a company that gives you a million options and your option moves up from 3 to 25 and again you've beaten time.

How about this real example of beating time — John Walter joined AT&T, but after nine short months he was out of a job. The complaint was that Walter "lacked intellectual leadership." Walter got $26 million for that little stint in a severance package. That's what you call really beating time. Of course, a few of us might have another word for it — and for AT&T.

NOTES & QUOTES: "Investors Are Reassessing Stock's Long-Run Potential" runs an article in a recent *Los Angeles Times*. The return in the decade of the 1990s was a sky-high 18.2% annually. But Roger Ibbotson (Yale professor and founder of Ibbotson Associates) says, "Part of the return that investors had over the past many years has been a windfall. You won't get it again."

Other investors such as Warren Buffett and Sir John Templeton are warning that over the next ten years you might not make anything in stocks.

This has enormous implications for baby boomers who are counting on retiring at the age of 55 or 60. They are basing their retirements on the same kind of returns that they received on stocks during the 1990s. But I have news for them – it's not going to happen. Stocks today are not priced for anything like the 18% annual returns of the 1990s.

In fact, because of the phony earnings, because of the fact that the S&P is now selling at better than 30 times earnings, the average portfolio (in my opinion) will be lucky to break even between now and the next eight to ten years.

Writes the *LA Times*, "There's nothing like a bear market to drive home the wisdom of diversification – that is, dividing your savings among a range of investments, including stocks of large and small companies, bonds, real estate and money market accounts.

"Not only is retirement less of an option, but Americans who based their planning on overly optimistic stock market returns may need to work past the normal retirement age to make sure they don't outlive their savings."

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In a bear market, unfortunately, what's good has a way of turning bad. Take the Maquiladoras in Mexico that everyone was so excited about over recent years – particularly here in San Diego. The Maquiladoras are the low-wage factories that have been dotting Mexico.

Now I read in the *San Diego Union* about the "Maquiladora Mess." Factories are being hit with declining sales, higher costs and red tape. As a result, many factories are being closed down and as one manufacturer says, "It's very difficult to break even. It's cheaper to transport the same products from Asia." So as one owner puts it, "For the first time in a decade, the industry's employment and sales are falling." A strong peso and higher wages have made operations in Mexico much more expensive than in countries like Malaysia and China where wages are a tenth as much as in Northern Mexico.

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How are the universities doing with their endowments? Not bad, considering it's a bear market. Harvard with a monster $18.3 billion showed a negative 2.7% rate of return in 2001. Yale with $10.7 billion was up 9.2% in 2001. University of Texas system with $9.4 billion was down 3.5%. Princeton with $8.4 billion was up 2.4%. And Stanford with $8.3 billion was down 2.0%.

A few weeks ago Caltech received the biggest gift of any university in history, $600 million from Gordon Moore, billionaire co-founder of Intel and a Caltech graduate. This is a monster gift to Caltech, with only 2,000 students, half of them graduate students. Caltech runs NASA's Jet Propulsion lab as well as major observatories in SoCal and Hawaii. Caltech has graduated an amazing 28 Nobel Laureates.

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The biggest foundation on earth is the Gates Foundation, which has $24.2 billion in its coffers. By US law a foundation must give way 5% of its assets annually. This means that the Gates Foundation must give away $3.3 million a day. The Gates Foundation is run by three people, Bill Gates and his wife Melinda, and Gates' father. The Foundation receives 2,000 grant applications and letters a month.

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Gaming, better known to realists as gambling, is running wild in the US. Many individual states, in dire need of tax money, are easing up on gambling restrictions. Get this – one third of the US's 560 federally recognized Indian tribes now run some sort of gambling venture as part of their $10 billion a year industry. But the wealth isn't distributed equally – the two Indian casinos in Connecticut — Foxwoods, run by the Mashantucket Pequots, and Mohegan Sun, run by the Mohegans, account for 20% of the $10 billion.

In Michigan, the Saginaw Chippewas do well – each adult member of the tribe receives an annual check for $52,000.

Indian territories are considered sovereign entities. But within many tribes there are fierce arguments as to whether the old conservative ways or the new money ways should run the tribes. The Saginaw Chippewas have expelled members who questioned the leadership's management of the casinos.

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One of the most successful investors of all time is Sir. John Templeton, the ultimate value investor. An article in *Forbes* magazine outlines Sir John's thinking. So what is he thinking? *Forbes* writes, "The bearish Templeton thinks the economy won't grow as quickly in the next decade as it has in the last one. That stagnation will hold inflation down and slam the stock market even more. Once investors wise up, he says, they'll crowd into nice safe Treasuries, bringing rates down." **Russell Comment** – As far as rates, that's already happened.

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Sign of the Times: An article in the November 12 issue of *Forbes* magazine is entitled "Rescuing Your Retirement. Your carefully laid plans for early retirement are dashed; your stock portfolio is decimated. What do you do now?" The *Forbes* answer: (1) Get rich slowly. *Forbes* talked about Treasury bonds and the risk of anything with greater yield. (2) Take calculated risks. (3) Thwart inflation. (4) Dodge taxes le-

gally with a 401 (k) or open a tax-deferred account. (5) Work longer. (6) Buy stock in the company where you work at a discount. (7) Buy a house and take the tax benefits. **Russell Comment:** I wasn't impressed with this list.

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Who are the healthiest people on the planet? Based on longevity, you'd have to say the Okinawans, since they are the world's longest-lived people. Okinawa has more 100-year-olds than anywhere else. The figure is 33.6 100-year oldsters per 100,000 people – this compares with about 10 per 100,000 in the US.

The 25-year Okinawa Centenarian Study discovered that compared with Americans, Okinawans have 80% lower risk of breast and prostate cancers; 50% lower risk of colon and ovarian cancer, 40% fewer hip fractures and minimal risk of heart attack.

So what's their secret? Okinawans are not in a hurry, they just take it easy, work at their own pace. They are relatively unstressed. Okinawans consume an average of 1,900 calories per day compared with 2,500 on the part of Americans. About 98% of a traditional Okinawa diet consists of sweet potatoes, soy-based food, grains, fruits and vegetables plus a small amount of fish and a little lean pork on special occasions. The typical Okinawa diet is low in fat and processed food. Okinawans drink about three cups of jasmine tea daily. Few elderly Okinawans have ever smoked, and there are very few overweight elderly Okinawans.

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Russell Comment: I went to an opening last week, and I watched a very thin, elderly black man playing the piano. He played for about two hours straight and was clearly enjoying himself. I talked to him after his session, and I asked him how old he was. He told me he was 93. I was amazed, and I asked him the secret of his health and energy at the age of 93. "Lots of women," he laughed. Hey, maybe he has something there.

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Who's making the big money in show business? Here goes — Whitney Houston — More than $100 million for a new multi-album deal with Arista. Mariah Carey — More than $100 million for a four-album deal with Virgin. Martin Lawrence — $20 million for National Security and $20 million for a Blue Streak sequel. Leonardo DiCaprio — $20 million for Gangs of New York. Ray Romano — $19 million plus per year for Everybody Loves Raymond. Brad Pitt — Around $18 million for Spy Game. David Chase — More than $15 million to exec-produce a fifth season of The Sopranos. Richard Gere — $15 million for Unfaithful and $15 million for Mothman Prophecies. Russell Crowe — $15 million for A Beautiful Mind. Ben Affleck — $12.5 million for Gigli.

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The new Nimitz class carrier, the USS Ronald Reagan, will be home-ported in San Diego. The nuclear powered aircraft carrier will arrive in 2004. Having a carrier in San Diego (this will be our second) is comparable to a Super Bowl, and will bring contracts worth about $80 million to locals. A carrier is comparable to a town of 5,000. San Diego already has the nuclear carrier Stennis. The Navy has nine carriers of the Nimitz class.

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For the first time in history there are six living US presidents. They are Ford, Carter, Clinton, both Bushes, and Reagan.

INVESTMENT POSITION:

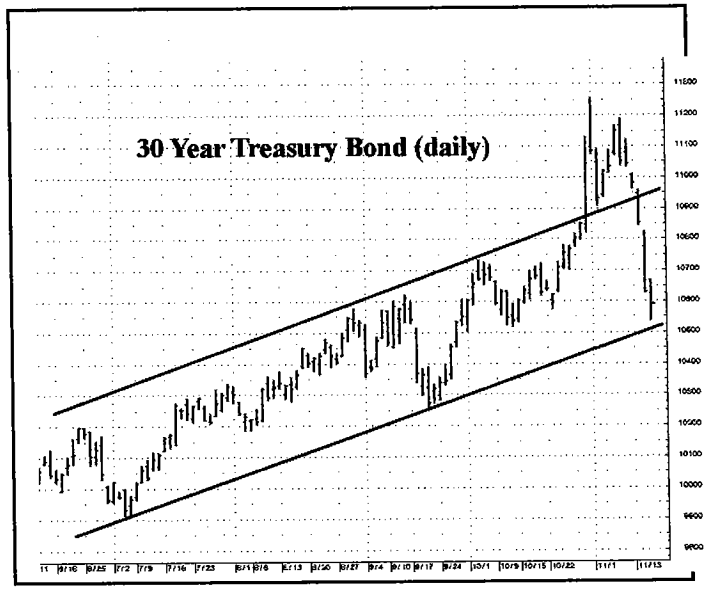
It's still a bear market. This is probably the time to skip dreams of doubling your money and to just think in terms of hanging on to your money. That means staying fairly short in top-grade money market instruments. Or if you are thinking "deflation" as I am, you will own some bonds.

I'm showing a daily chart of the 30-year T-bond (see page six). The bond has remained in a rising channel ever since June of this year. In November the bond "blew out" of the channel. Over the last week the long bond has dropped back into the channel again.

The question every bondholder is asking is whether that was a "blow-off top" or whether bond-buyers simply got too enthusiastic — and now bonds are simply dropping back within their rising channel again. The answer? I don't have it. I know a lot of "experts" are thinking that the bonds have topped out. But I'm certainly not convinced. Time to sell the long bonds and go short-term? I'm not ready yet.

You can make a good case for world deflation, and if so, high-grade bonds will be the place to be. As I write oil has dropped to 17.70 on the December contract. That, dear subscribers, is deflation. And so is the collapse in the commodity indices. "But what about all the Fed's inflation efforts?" you ask. Answer – so far, the forces of the bear market and deflation have been more powerful than all the frenzied inflation efforts of Mr. Greenspan and the Fed.

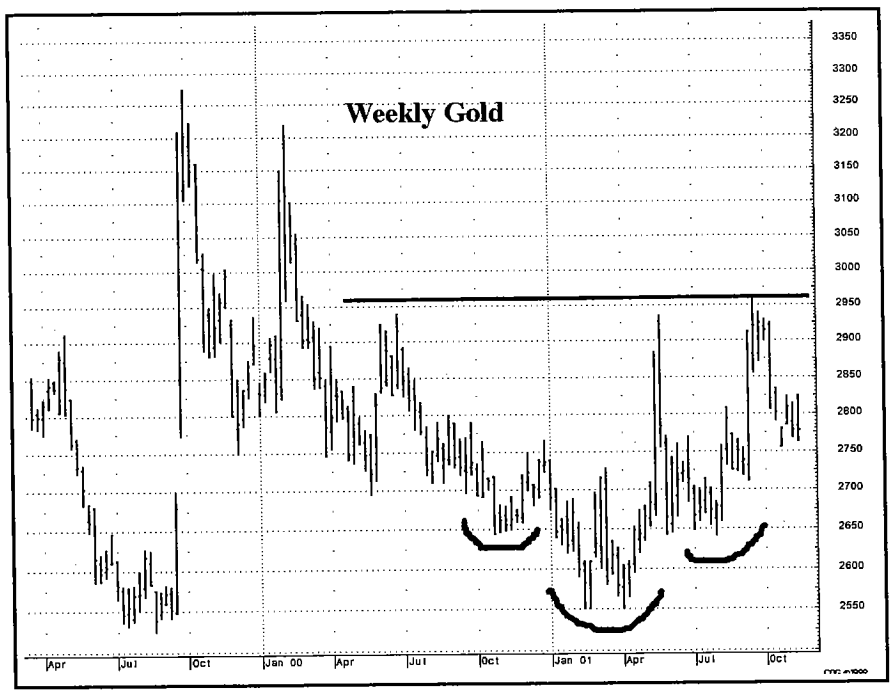
As for stocks, Dow Theory says it's still a bear market with a long way to go. Holding stocks in a bear market is never a healthy endeavor. At this point I'm not a stock buyer. They're expensive and buying them is really a bet that the September 21 low was the bear market low. I'm obviously far from convinced.



the Fed is fighting the primary trend of the market. So far, the primary trend has been more powerful than the Fed.

GOLD: The debate goes on as to whether gold is worth holding or whether gold is a lost cause. Like so many items in the market, the jury is out. Signs of deflation are everywhere, the latest being the collapse of oil to below 18 bucks a barrel.

This weekly chart of gold shows what I consider a huge basing pattern, with major resistance at the 295 level. In the meantime, the Fed has embarked on what might be called an all-out campaign to re-inflate the economy. Alas, Will gold be able to break out above the 295 level or will deflation hold it back? I wish I knew. It's a fascinating chart, and some gold-philes note that gold can go up, even in a deflationary atmosphere. Others are convinced that there's a conspiracy to keep gold in the cellar. My own instinct is to buy some of the metal and hold it forever. I don't know about timing but I do know that gold will be around long after the dollar is a memory.



NOTICE to our web subscribers: Many of you will be pleased to learn that effective with our next Letter (#1328) the Dow Theory Letter will be available in a new layout as a regular web page and will not require the Adobe Acrobat Reader (not a pdf file). This will enable many of you web tv subscribers to view the Letter.

LATE NOTES: As I'm writing this (morning, Nov. 19) the Dow is flirting with its 50% or halfway level, that level being 9978. I've drawn a lot of attention to this "halfway" level. If the Dow can close above 9978 there is a reasonable chance that it can continue further, even attacking the bull market high of 11722. Only time will tell. Question – If the Dow closes and consolidates above 9978, should we play the upside? If you want to trade, and have the stomach for buying stocks just for trading purposes, my answer is "sure, go ahead."

However, I'd play the upside with DIA and and SPY which are both traded on the AMEX.

Next Mailing: December 12, 2001